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External Financing for Indonesia Post-2003

A report for the Coordinating Ministry for Economic Affairs

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12 October 2002

Funded by the Partnership for Economic Growth (PEG)[1]
A USAID/GOI Project

[1] The Partnership for Economic Growth (PEG) is a United States Agency for International Development (USAID)-funded Project with the Government of Indonesia. The views expressed in this report are those of the author and not necessarily those of USAID, the U.S. Government or the Government of Indonesia.

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The Scope for Increasing Donor Aid Flows in 2004-2005

EXECUTIVE SUMMARY

- Only three donors account for 90% of the aid Indonesia receives from foreign donors: World Bank/IDA, Asian Development Bank/ADF, and Japan. Ramping up disbursements of aid to ease the fiscal shock of resuming Paris Club payments after 2003 will depend critically on actions by these three donors.

- All three have substantial pipelines of undisbursed assistance. There is scope for accelerating disbursements, but pushing up the disbursement rate in 2004 would probably require early and convincing action by the government to remove existing obstacles (cabinet decisions, parliamentary action, etc.).

- The trend of disbursements is currently downward. Donors appear to be assuming a continuation of this trend as Indonesia's economy recovers and domestic pressures to reduce dependence on foreign aid gather strength. Lead times for new projects can be quite long, as much as 2 years.

- World Bank disbursements in 2000-2001 were $600-700M. Disbursements in 2002-2003 appear headed toward the $500-600M range, and lower in the following years. Strong efforts by the government could push this level up to around (or even slightly above) $1B in 2004—in effect moving to the "High Case" limit of $1B.

- ADB disbursements in 2000-2001 were $500-600M. Disbursements in 2002-2003 appear headed toward the same range or possibly higher. An upper limit for 2004 of $1.1B is being considered. Strong efforts could bring disbursements close to this level. Numerous potential projects have been identified.

- Japanese disbursements in 2000-2001 were $500-600M. Due to its fiscal constraints and other international priorities (including North Korea), the Japanese government may resist increasing new financing substantially. However, if the World Bank and the ADB are prepared to do more then it may be easier for the Japan government to disburse more than $1B as well, ideally by co-financing with World Bank and ADB program/sector loans.

- <u>The government's message at the end-October CGI meeting could be critical. Unless it makes a strong case for reversing the current trend, the chances of maintaining the current disbursement level through 2004 will fade</u>. <u>Without early and strong efforts to prepare new fast-disbursing program and sector loans, there will be little chance of moving the disbursement level from the three major donors together from $1.5B in 2002 to $3.0B in 2004.</u>

The Scope for Increasing Donor Aid Flows in 2004-2005

Overview

One of the attractions of borrowing from aid donors is its low cost relative to domestic financing and borrowing from private sources. The average interest rate on Indonesia's entire stock of external debt (including private sector) is 3.5% compared with 13.8% being paid on domestic debt (excluding debt to Bank Indonesia), and compared with interest on foreign private debt of at least 7% (based on the secondary market yield of the government's Yankee bond). The interest rates on new loans from the World Bank and the ADB and Japan are likely below 3.5% at present.

Since the 1997-98 crisis, donor disbursements (gross) have consistently fallen below the amounts committed. Both have been on a declining trend:[2]

($ billions)	Total		Program Aid		Project Aid	
Year	Pledged	Disbursed	Pledged	Disbursed	Pledged	Disbursed
1998/9	$7.9	$5.5	$4.7	$4.0	$3.2	$1.5
1999/0	5.8	3.7	3.2	1.9	2.6	1.8
2000	4.7	2.1	2.7	0.2	2.0	1.9
2001(p)	4.8	2.6	2.6	0.9	2.2	1.7
2002(e)	3.3	?				
2003(e)	2.2	?				
Total	$23.2	$13.9	$13.2	$7.0	$10.0	$6.9

(p=preliminary; e=estimate)

Reversing this trend to achieve a substantially higher level of disbursements in 2004-05 will require early and vigorous action by the government.

The following sections identify large projects already approved and in preparation for approval in the next 1-3 years. Efforts to accelerate disbursements are likely to be most productive if they are focused on these projects. Most of the obvious areas of reform are covered, but four areas seem to be getting little attention relative to their importance to Indonesia' future growth prospects. These are:

--*Power sector reform*. Demand for electric power has been growing rapidly since the 1997/98 crisis but little capacity has been added. Within the next 2-3 years, the investment required to keep pace with demand may be on the order of $2B per year, which would only be available from private sources. (To start the process, the government may have to provide partial guarantees.) Because of the long lead times involved in building capacity, decisions on which projects to support will need to be made in the near term. Progress toward full cost recovery in electricity tariffs will be key to attracting private financing. In the meantime, adjustment loans from the World Bank and ADB could support structural reforms in this sector, possibly with cofinancing from

[2] Brief for the CGI, 2 November 2001

Japan. A $500M loan in 2004 may be feasible. Project financing from certain donors may also be feasible on a substantial scale, but the lead times would probably put off any substantial impact on disbursements until 2005.

--*Financial sector reform*. The sale of BCA has been completed. The sale of Bank Niaga is in process and the sale of Bank Danamon is pending. The Sovereign Borrowing Law has been passed and the issuance of domestic securities by the government is imminent. IBRA is in a position to conclude its loan sales by the end of next year. Together, these recent developments suggest that the government has made sufficient progress to justify substantial sector lending from the World Bank or the ADB to "complete" the reform process. This might involve achieving some subset of the following: completing the recapitalization or sale of some or all of the remaining four state banks (especially Bank Mandiri), establishing a financial sector supervision agency, putting in place a deposit insurance system (enabling the government to withdraw its guarantee), steps to address financial fraud and abuse, and further reforms of Bank Indonesia to better focus on its central banking functions. For example, assuming the government's vision of the financial sector crystallizes in 2003, $500M sector loan that begins to disburse at the end of 2004 could help to advance implementation. (The World Bank mission has indicated that it would defer to the ADB in this area.)

--*Forestry protection*. Illegal logging and the burning of forests are eroding valuable biological resources and affecting other countries in the region. Indonesians as well as donors have been pressing the government to slow the rate of deforestation. A substantial loan to support action in this area could help to build a national consensus for reform.

--*Marine resource protection and security*. Damaging fishing practices, sand mining, smuggling and piracy represent threats to future economic growth. Here also, Indonesians and donors have urged the government to do more. Similarly, a substantial loan could help to advance reforms in this area.

World Bank/IDA[3]

According to World Bank data, Indonesia's three largest donors measured by gross disbursements in the 1998-2001 period were IBRD/IDA ($3.6B), ADB/ADF ($3.2B), and Japan ($3.1B). Together these three donors accounted for 93% of the loans disbursed by all CGI donors in this period.[4]

Under the World Bank's Country Assistance Strategy (CAS) for 2001-2003, the level of financing is linked to Indonesia's economic policies and reform measures. Under the base case of muddling through, financing is limited to a blend of IBRD and IDA funds up to $400M per year (the fiscal year 2003 breakdown is $265M and $135M respectively). Financing could rise to $1B, with IDA credits capped at around $400M, if Indonesia

[3] Information drawn from CAS Progress Report, September 2002, except where noted.
[4] Commitment and disbursement table from Bert Hofman, 24 September 2002.

takes specific steps spelled out in the CAS. Moving to the high case would also permit $200M to be in the form of fast-disbursing loans.

The current trend in commitments and disbursements is more downward than upward, in the face of delays in implementing various reforms agreed to by the government. The following figures highlight the trend (2002 estimates were not available):

($ millions)	1998/99	1999/00	2000	2001
Disbursement plan	2700	2384	1500	1515
Actual	925	1425	694	585

At the same time, Indonesia has been making large repayments on its outstanding stock of debt to the World Bank/IDA ($12B). Principal repayments in 2001 were just over $900M and interest payments were over $300M, resulting in net repayments of about $300M and net transfers of about $600M.

Even if all the remaining steps required to qualify for the high case level are taken by the time of the October 28-29 CGI meeting, it might not be feasible to push the disbursement level above $700M in 2003 due to the time required by the World Bank to shift gears. <u>A determined effort could, however, push disbursements to the high case level of $1B in 2004. This would require vigorous action on existing projects and accelerated preparation of new large-scale fast-disbursing projects</u>.

As of 31 August 2002 (the beginning of the World Bank's fiscal year), the amount of undisbursed World Bank/IDA loans was $1.6B for 45 separate projects. (The disbursement rate has been low in Indonesia compared to other countries, suggesting that the constraint is more a function of Indonesian implementation than World Bank practices.) Pushing up the disbursement level would depend on progress with the projects having the largest undisbursed balances. These include seven with balances above $50M:

Project	FY Approved	Amount Undisbursed[5]
Kecamatan Dev. II	2002	$306M
E. Indonesia Region Transport	2002	184M
N. Sumatra Region Roads	1998	105M
Provincial Health II	2001	100M
Urban Poverty II	2002	100M
Railway Efficiency	1997	67M
Water and Sanitation LIC II	2000	71M

The Kecamatan Development Project II is working with a tested process, but it involves a full year of "socialization" before substantial disbursements begin in 2003. The disbursement rate at that point should be relatively fast, with around $100M possible in 2004. The two road projects and the railway project are slow-disbursing (about 5 years). Together they appear unlikely to yield disbursements in 2004 much above $100M.

[5] Amounts from Bert Hofman, 24 September 2002. Projected disbursements from project managers.

Provincial Health II only became effective in mid-2002. It has a central government component that is on track and a regional component that is stalled pending a government decision on on-lending. The loan is expected to disburse over 5 years. [Awaiting information on Urban Poverty II] Water and Sanitation Low-Income Communities II has a 5-year disbursement profile and is on track. Altogether, disbursements from these major projects in 2004 may be on the order of $250M. Adding up disbursements under the smaller projects is unlikely to yield a disbursement level above $300M in 2004 compared with the 2002 rate around $425M. (The second $150M tranche of the Water Resources Sector Adjustment loan was due to disburse in 2002 but is expected to slip into 2003, thereby pushing the 2003 disbursement level to almost $600M.) Disbursements would have to be pushed up above $1B to achieve positive net financing from the World Bank/IDA and above $1.3B to achieve positive net transfers.

Two projects scheduled to be approved in the next fiscal year (beginning 1 July 2003) could be critical to keeping the disbursement rate from falling in 2004. With both projects, there appears to be some potential for increasing the size of the project:

- Energy, $100M
- Kecamatan Dev. III, $140M

Another large project is due to be approved at the end of 2003, but disbursements in 2004 are unlikely to exceed $25M:

- Eastern Indonesia Region Roads II, $200M

A potentially bigger project is scheduled for Executive Board approval in May 2004, but it is expected to disburse over 6 years:

- Strategic Road Infrastructure, $200M

Two other large projects are "under discussion" that could generate substantial disbursements in 2004 and 2005. No amounts are given for these projects:

- Gas sector
- Strategic Urban Transport Infrastructure

A Kabupaten Government Reform loan ($50-60M) is under discussion, but appears unlikely to reach the Executive Board approval stage until the Bank's fiscal year 2004 (beginning 1 July 2003). Its fate depends critically on the adoption of an on-lending policy by the government. A similar Urban Local Governance Reform loan ($50M) is under discussion for the same time-frame. A Health Workforce loan is in pre-appraisal that is notionally for $65M, but it could be expanded to $100M. All three would disburse over 4-5 years, with relatively little expected in 2004.

With a strong and early effort, new fast-disbursing sector adjustment loans could be developed in three other areas:

- Procurement reform
- Government financial management (including expenditure management and tax administration)
- Decentralization reform

The Asian Development Bank/ADF[6]

The ADB's assistance to Indonesia is being implemented in the framework of the Country Assistance Strategy (COS) for 2001-2005. This framework targeted a range of $600-1,200M of lending (signed loans) per year. According to the recent draft Progress Report, the realistic upper limits now are $1,000M for 2003, $1,100M for 2004, and $1,200M for 2005. (Only $100M of this per year is concessional ADF financing in the replenishment cycle through 2004 in the "base case." The ADF amount falls to $80M if the government is unable to meet specified performance indicators.) The World Bank gives the following figures for the ADB's planned and actual disbursements (2002 estimates were not available):

($ millions)	1998/99	1999/00	2000	2001
Disbursement plan	2200	1600	1065	1515
Actual	925	1216	474	617

The ADB has 14 active projects with undisbursed balances exceeding $50M, totaling roughly $1,810M. The top five are:

Project	Year approved	Amount approved	Undisbursed
Gov. reform/sector dev.	1998	$1,400M	$350M
State enterp. governance	2001	400M	250M
Power sec. rehabilitation	1999	380M	180M
Tech/prof skills	2000	180M	163M
Power dev and efficiency	1995	177M	115M

At the current disbursement rate of 18%, these 14 major projects would yield $350-400M of disbursements in 2004, not enough to keep the disbursement level from falling. (According to an ADB power sector expert, $200M from the ADB and $180M from Japan are expected to be disbursed before the end of 2002, linked to the recent passage of the Electricity Law.)

Going forward, the ADB lists 25 "firm" projects on the order of $100M (smaller projects are more numerous). These are all in the priority areas of governance, decentralization, social services, environment, and infrastructure:

--in 2003, eight projects totaling $775M
--in 2004, ten projects totaling $950M
--in 2005, seven projects totaling $900M

<u>The tentative lending "ceiling" of $1,100M in 2004 appears to be with reach, but only by actively pursuing without delay two or three large fast-disbursing program/sector loans as well as efforts to unblock disbursement of active project loans</u>.

[6] Information drawn from draft report Country Strategy and Program, 2003-2005, September 2002.

Japan

The World Bank reports the following pattern of actual disbursements against planned disbursements for Japan.

($ millions)	1998/99	1999/00	2000	2001
Disbursement plan	1500	1200	1560	1794
Actual	686	1285	467	628

Japan's pledge at last year's CGI meeting was $720M, consisting of $568M of project lending, $92M of program lending, and $60M in the form of a "financial grant." Actual disbursements of program lending in 2002 will be substantially higher, however, because a $200M power loan (cofinanced with the ADB) that was pledged for 2001 was carried over and will be disbursed in 2002. At the same time, the disbursement rate for project assistance is running behind the pace pledged and is likely to be around $400M for the year, yielding total disbursements on the order of $750M.

Based on a recent visit by Japanese aid officials, it appears that Japan would like its program lending component to decline as Indonesia's recovery advances. Accordingly, Japan may pledge less than $90M of program lending at the October 2002 CGI meeting. The amount pledged for 2004 could be lower still, unless the government makes a strong case for reversing the trend. Resuming principal and interest payments in full on pre-cutoff debt to Paris Club creditors (that has been rescheduled for the 2002-2003 period) will increase payments to Japan on the order of $1.8B (60% of payments to all Paris Club creditors). This means that Japan would have to disburse more than $1.4B of new loans to achieve a positive net flow of financing to Indonesia and more than $1.8B to achieve a positive net transfer. <u>By this measure, pushing the disbursement rate in 2004 to the $1B level might be a reasonable objective for a difficult transition year</u>.

Other Donors

There are 18 other donor countries participating in the CGI. None of these have been disbursing loans to Indonesia at a pace above $100M per year. The biggest lenders after Japan appear to be the United States, Austria, France, South Korea, and Germany. Much of the donor aid pledged in the CGI represents grants and only a small portion of these grants finances budget expenditures. One exception, however, is cofinancing from the Netherlands for World Bank projects. (<u>In one current project, as much as $40M of Dutch cofinancing may be lost if Indonesia is unable to meet conditions of disbursement by the end of 2002.</u>)

United States. The activities supported by AID, in the range of $100-$130M per year, are entirely grant funded. None of these grants go through the budget, but the total is included in the US pledge. For 2002, the US also pledged up to $400M of Eximbank and OPIC loans to support private sector projects, which falls outside the budget. In addition, the US provides financing for agricultural imports under the PL480 (concessional) and CCC (nonconcessional) programs. The PL480 level is currently around $20M per year; it is not clear whether this is in the budget or not. CCC credits have gone as high as $750M in a single year and in US fiscal years 2000 and 2001 Indonesia was the largest market in the world for CCC-financed exports. The amount programmed for the last US fiscal year was zero because the Indonesian government was unwilling to guarantee repayment. A proposal is now being considered by CCC to waive the guarantee requirement and resume financing at the $100-200M level. Since these finance private sector imports, they do not contribute to the government's financing requirement.

Further inquiries would be required to evaluate the relevance of pledges by other donor countries to the government's financing requirement, but the total amount of budgetary support from all non-Japanese donors appears to be relatively small (perhaps less than $200M).

Strategic Issues

1. *Budget impact*. Program and sector loans have two advantages over project loans in the context of addressing the fiscal shock in 2004. First, they tend to be large and fast disbursing—typically they would be in the range of $50M-$500M and they would disburse within a year or two. Second, they do not divert budget resources from other priorities. A $50M program loan finances $50M of expenditures that reflect the government's existing priorities. By contrast, a $50M project loan will finance only the foreign currency costs of a larger project (say $75M). The government has to divert $25M of expenditures from other projects to finance the local currency costs of the aid project. (To the extent that the donor is prepared to finance the local currency costs, this portion of its financing is equivalent to a program/sector loan.) However, additional project loans in areas that do not result in a reduction in rupiah financed projects raise the deficit and are less advantageous especially, especially in as far as there is a budget deficit target.

2. *National vs. regional programs*. The process of decentralization has been relatively smooth so far, but the capacity of the regions to absorb foreign aid remains quite limited for a variety of reasons. This means that the success of an effort to ramp up donor disbursements may depend in part on designing programs and projects that will be implemented by the central government.

3. *Grants vs. Soft Loans vs. Hard Loans*. There is an ongoing public debate in Indonesia about the forms and purposes of aid loans. One group argues that Indonesia has excessive debt and should not borrow any more and only seek grant financing from aid donors. Another group argues that more borrowing from aid donors is sustainable as long as it is on concessional (ODA) terms. A third group argues that borrowing from aid donors is sustainable only when the proceeds are used exclusively for projects that generate revenues at least equal to the repayment requirements. A fourth group argues that foreign borrowing is only sustainable when the projects supported are efficient (fraud and abuse are minimized). The technical argument is straightforward: as long as the economy grows at a rate faster than the real interest rate on new borrowing, the borrowing is sustainable because the stock of external debt will decline relative to output

(GDP). This is true even if all the loans are for projects that have zero or even a negative impact on productivity. The political dimension of this issue is equally if not more important, however. The perception is that past loans to Indonesia did not benefit the general public which is now saddled with the burden of repaying these loans. There may be no "technical" solution to this problem. The perception is unlikely to change until the general public is persuaded that new projects are benefiting them rather than small interest groups

4. *Simplification*. Managing foreign aid is challenging in a country like Indonesia because of the competing or conflicting requirements of a large number of donor agencies and programs. In recent global discussions (e.g., at the recent annual meetings of the IMF and World Bank), there have been extensive discussions of aid effectiveness. Donors are now expressing a stronger commitment to simplifying their procedures and requirements to be more realistic and to promote recipient country "ownership." There may be opportunities for Indonesia to capitalize on this change in sentiment by proposing specific steps to simplify aid, such as joint financing.

5. *Conditionality without the IMF*. Assuming Indonesia will not have a formal program with the IMF after 2003, Indonesia can expect to face concerns among donors about macroeconomic policy objectives in the following years and these concerns could make it harder to ramp up donor disbursements. Various approaches could be taken to alleviate these concerns. For example, the government could announce a 3-year program at the 2003 CGI meeting and invite donors to provide program loans linked explicitly to meeting the intermediate targets in this program (budget deficit, credit expansion, etc.). Another possibility would be to link program loans to the IMF's post-program monitoring. A third possibility would be for three individual donors to link their program loans to three separate macro performance indicators.

Borrowing from the Private Sector

EXECUTIVE SUMMARY

- The Indonesian government has not borrowed from private sources since the 1997-98 crisis. The government's outstanding debt to private creditors is quite modest by international standards. Its debt to commercial banks is around $1.8B (excluding Exchange Offer debt). Principal payments on this debt have been rescheduled since 1998 in the London Club, in accordance with the Paris Club's comparable treatment requirement. The government has one outstanding sovereign bond maturing in 2006 ($400M) that has been serviced without interruption.

- Indonesia appears to have room to borrow modest amounts of financing either in the form of bank loans or bond issues. Under current circumstances, Indonesia may have access in the mid-2003 to end-2004 time frame to amounts up to around $1B under reasonable terms. According to BI, the current yield on Indonesia's Yankee bond is just under 6% (a spread of 350 basis points over the risk-free US Treasury yield). Additional borrowing could be available at close to this yield/spread, depending on the characteristics, timing, etc.

- Access to private financing, however, depends heavily on Indonesia's relations with the IMF, the CGI, and the Paris Club. Strong support from the IMF would help to borrow commercially on favorable terms, and CGI support works in the same direction.

- The government could find some value in forming a "private sector advisory group" to help refine a strategy for resuming access to private lending. Tangible benefits could also come from agreeing to include "collective action clauses" in any future sovereign bond issues.

- A government decision to seek Paris Club relief beyond 2003 would seriously impair access to private financing, in part because of the comparable treatment requirement that would force Indonesia to reschedule again its debt to commercial banks. Full rescheduling of principal and interest could effectively rule out borrowing from private sources. A credible 2-3 year plan for phasing out Paris Club relief could make some lesser amount of market access feasible.

Borrowing from the Private Sector

The Indonesian government has borrowed very little from private sources in the past, which contributed significantly to perceptions of the country's creditworthiness prior to the 1997-98 crisis. It has undertaken no new borrowing from these sources since the crisis. As of mid-2002, there were three bodies of debt owed to the private sector: a Yankee bond, syndicated bank loans, and "exchange offer debt" related to the banking crisis.

Syndicated bank loans. According to the latest BI report, the government's debt to commercial banks is $1.8B (including $0.8B that has been rescheduled). Principal payments falling due since 1978 through 2003 have been rescheduled in the London Club process, as required by the Paris Club to achieve "comparable treatment." The remaining unrescheduled amounts are due to be repaid in 2004 and 2005, $500M each year. Principal repayments on London Club I and London Club II begin in 2002 and 2003, but at modest levels (under $50M).

Yankee bond. A $400M bond was issued in 1996 in New York. It matures in 2006. This obligation has escaped rescheduling as an exception to the Paris Club's "comparable treatment" requirement justified by the small size of the issue. A request for Paris Club rescheduling in 2006, however, could jeopardize this issue because of the current G7/IMF policy on "private sector involvement" (PSI, burden sharing).

Exchange Offer debt. At the time of the crisis, the government guaranteed repayment of outstanding interbank lines of credit from foreign banks to Indonesian banks, and these amounts were rescheduled under an "Exchange Offer" arrangement ("Frankfurt Agreement"). This debt only becomes an obligation of the government to the extent that the Indonesian banks are unable to make the payments due under the Exchange Offer arrangement. The obligations of the state-owned banks ("frozen banks") have become in effect obligations of the government, but most of the Exchange Offer debt is owed by private banks ("non-frozen banks") and is being paid down on schedule. The Paris Club has been concerned about the preferential treatment being given to this debt, but the government has argued successfully (with the help of the IMF) that this is short-term debt that is not normally subject to the comparable treatment requirement. The latest figures for the outstanding amount of Exchange Offer debt were not requested, but was $3.5B as of end-March 2001 and is probably close to $2.5B now, the bulk of which is owed by non-frozen banks. It is scheduled to be fully repaid before the end of 2005.

The Potential for Borrowing from Commercial Banks

Most top-tier international banks (US, Europe, Japan) appear to be strongly disinclined to increase their exposure to Indonesia under any circumstances. However, any hint that the situation is improving faster than expected (reversal of capital flight, other banks starting to lend to companies emerging from IBRA/JITF restructuring) could change bank attitudes quickly. Some Asian banks may be eager to lend to the government, but the terms may be less attractive and there could be unwelcome quid pro quos. The pending change in capital adequacy rules for banks (Basel II) is having the effect of making banks less interested in lending to emerging market governments because of the substantially higher capital charges required compared to the Basel I regime.

If the government decides to seek Paris Club rescheduling after 2003, it will have to negotiate another London Club agreement because of comparable treatment. This would preclude any new borrowing from most banks on reasonable terms (under 500 basis points over LIBOR or an equivalent market rate).

If Indonesia has made a credible commitment to resume full payment to Paris Club creditors at the beginning of 2004, then the government may receive serious proposals from banks for new lending as early as mid-2003. It seems unlikely, however, that the total amount of borrowing from this source could exceed $500M in 2004 without pushing up the risk premium. This would be for maturities of 5 years or less.

The terms of commercial borrowing will be affected by market assessments of the default risk associated with lending to the government. These assessments are reflected most clearly in bond ratings and in the premiums charged by export credit agencies. In the case of export credit agency premiums, the ECAs in the OECD countries work with a scale of seven categories with Category One including the least risky borrowers and Category Seven including the most risky borrowers. Currently, Indonesia falls in Category Six (along with Bangladesh, Brazil, and Turkey). For a full guarantee on a loan with a two-year drawdown period and a 10-year repayment period (with the fee paid as drawn) to Indonesian borrowers, the US Eximbank would charge a premium of

- 26.2% (2,618 basis points). This compares with a premium of:
- 19.5% for Category Five countries (Sri Lanka, Vietnam, Peru, Russia),
- 13.5% for Category Four countries (Philippines, Egypt, South Africa),
- 8.6% for Category Three countries (Thailand, India, Mexico), and
- 4.9% for Category Two countries (Malaysia, Korea, China, Chile).

More favorable terms on borrowing from commercial banks could be obtained by securitizing the debt in various ways. The most obvious would be with oil/gas receipts. Unfortunately this option may be precluded by the negative pledge clause in existing loans, and thus would have to be agreed on with existing creditors. Assuming that Indonesia’s economic prospects continue to improve, and it moves from Category Six to category Four in the ECA matrix for example, the government would at some point be able to issue without securitization.

The Potential for Capital Market Borrowing

At the moment, there appears to be somewhat greater market appetite for Indonesian bonds than for bank loans. A small issue ($200-300M, maturing in 5-6 years) in mid-2003 could be undertaken to test the market’s appetite. The cost might be reduced through various securitization techniques, but this may not be necessary. A partial guarantee from the World Bank or the ADB might be worth pursuing, however. The size, tenor and timing of subsequent issues would be determined by market conditions. However, it seems unlikely that the bond market would easily absorb more than $1B of Indonesian issues by the end of 2004. If the government decides to move in this direction, it can expect to a steady stream of visitors from leading investment banks seeking a mandate.

Another "wrinkle" could be to include "collective action clauses" in future sovereign bond issues. Intensive work is underway on these clauses by the G7/G10 Finance Ministers and the IMF in the context of ensuring "private sector involvement" in future financial crises. The financial industry (led by the Institute of International Finance (IIF)) is also working intensively to develop a mutually agreeable set of clauses. So far no emerging market country has agreed to adopt these clauses and some leading borrowers (including Mexico) have expressed strong reservations about their benefits. Indonesia, however, is in the rare position of having only one outstanding sovereign bond, and one that matures in the near term (2006). As a consequence, it could be a prime candidate to begin using these clauses. An expression of interest by Indonesia might yield tangible benefits in terms of G7/G10/IMF support for generous commitments of multilateral and bilateral financing for Indonesia.

Market Appetite and Prudential Limits

The suggested absorptive capacities for commercial bank debt and bond debt should not be seen as additive. Borrowing to the notional limit of $500M from banks would reduce the market appetite for bonds possibly on a one-for-one basis. This suggests that combined borrowing of both types in the $500M-$1B range in 2004 may be feasible.

Under the current IMF arrangement, there is a limit of $150M on "contracting or guaranteeing by the central government or Bank Indonesia of new debt to commercial creditors" (excluding official export credit or other credit guaranteed by official creditors). This and similar limits in the past have not been binding because the government has not engaged in borrowing relevant to this limit. If there is no IMF arrangement beyond 2003, this limit would no longer be binding. Nevertheless, the government may wish to bear in mind that the IMF will be monitoring any government borrowing from private sources. It appears that borrowing from commercial sources up to $1B in 2004 would be viewed as prudent as long as it is seen as part of a Paris Club exit strategy and not the beginning of a borrowing binge.

For any commercial borrowing, the declared use of the proceeds will have a major impact on market appetite and terms. The most favorable impact presumably would be associated with a commitment to use the proceeds to retire domestic debt in the context of a fiscal deficit target of zero or close to it. The worst impacts would be associated with borrowing perceived to be financing a growing budget deficit or projects of questionable merit.

A Private Sector Advisory Group for Indonesia

In the context of the global debate about the role of the private sector in crisis prevention and crisis resolution, the IIF, representing the global financial industry, has proposed that emerging market countries concerned about maintaining or regaining access to private capital flows form a "private sector advisory group." This would be a small number of eminent executives from leading firms who would meet periodically with the top financial officials from the country to exchange views about general market conditions and trends as well as specific market concerns or opportunities for the country involved. As a G-20 country facing market access issues, the financial industry would presumably be receptive to forming such a group for Indonesia, and Indonesia might benefit from such a group in developing a strategy for resuming borrowing from private sources.

Paris Club Debt Relief

EXECUTIVE SUMMARY

- A review of the Paris Club's case history suggests that Indonesia will not be able to obtain debt relief from the Paris Club without an IMF agreement.

- Under Paris Club III, interest rescheduling in 2003 is contingent upon a determination by the IMF that such support is necessary. This suggests the Paris Club is unlikely to be comfortable rescheduling interest beyond 2003 unless Indonesia's prospects deteriorate substantially (and maybe not then if the cause is policy slippages).

- The Paris Club has provided relief since 1998 in the expectation that Indonesia's economic recovery would soon make such support unnecessary. It might be argued that by agreeing to more interest rescheduling in 2003 the Paris Club is helping Indonesia resume servicing of scheduled payments after 2003.

- The Paris Club almost certainly recognizes that resuming full payment in 2004 would represent a substantial fiscal shock. Thus, the Paris Club is likely to agree to reschedule beyond 2003 as long as a clear exit path is established, there is a supporting IMF arrangement, and balance of payments shortfall can be demonstrated.

- There is a trade-off between Paris Club rescheduling and new financing. If Indonesia decides to seek more rescheduling, then it will be harder to push up the pace of donor disbursements. A rapid phase out of rescheduling in 2004 and 2005 could be supported by a significant increase in new financing.

- The cash flow impact of Paris Club rescheduling is immediate and its conditionality is not additive to IMF conditionality. By contrast, the cash flow impact of new donor financing is stretched out over a longer period (unless it is in the form of front-loaded program/sector loans) and its conditionality is both additive and complex (each donor tends to have a different set of conditions).

- Debt reduction from the Paris Club is a non-starter (because Indonesia's prospects are too good). An effort to become eligible for reduction through the Heavily-Indebted Poor Country (HIPC) Initiative would be a step backward from the objective of restoring creditworthiness and regaining access to private sources of capital. It would also undercut Indonesia's role on the World Stage. (It is hard to imagine Indonesia as both a HIPC and a G-20 member).

- The Paris Club has extended special terms to several countries in recent years (Jordan, Pakistan, Cote d'Ivoire, Nigeria), but these cases do not appear to offer relevant precedents for Indonesia.

Paris Club Debt Relief

A. Rescheduling without the IMF

Can Indonesia obtain Paris Club debt relief after 2003 without an IMF agreement? A review of the Paris Club's case history suggests that it will not be able to.

The "rules and principles" of the Paris Club are presented on the Paris Club's own web site (www.clubdeparis.org). The third principle listed is "conditionality." The web site explains that debt relief is provided by Paris Club creditors "only for countries that need a rescheduling and that implement reforms to resolve their payment difficulties. <u>In practice conditionality is provided by the existence of an appropriate programme supported by the IMF, which demonstrates the need for debt relief.</u>" (emphasis added)

Precedents do exist for Paris Club debt relief without an IMF program, but they are not relevant to Indonesia's case. For example, the Paris Club has negotiated debt relief agreements with several countries that were not members of the IMF (Cuba, Mozambique, Poland in 1981). Also, in the late 1960s and early 1970, India and Pakistan obtained debt relief as a form of aid through their aid consortiums. This experiment was ended by creditors in the 1970s, in part to defend against demands for generalized debt relief from the South in the North-South Dialogue. Even the generalized debt reduction for Heavily-Indebted Poor Countries (HIPCs) carried out since 1996 has been implemented through the Paris Club and always after the country has reached agreement with the IMF on a 3-year program supported by an arrangement under the PRGF (Poverty Reduction and Growth Facility, the "soft loan" window that replaced the ESAF-Enhanced Structural Adjustment Facility).

The word "appropriate" in the Paris Club description of conditionality is also significant. The Paris Club granted debt relief to Nigeria in 2000 based on a "precautionary" arrangement with the IMF (the conditionality was equivalent to a stand-by but Nigeria expressed its intention not to make any drawings under the arrangement). Exceptional political considerations (mainly a successful democratic election, NGO interest in alleviating African poverty, and a curious debt profile) made this experiment possible, but it was not considered a success. (See Annex A.) It is unlikely that Indonesia could obtain Paris Club relief under a precautionary arrangement in the current political climate.

In short, Paris Club debt relief beyond 2003 will require a conditional IMF lending arrangement and meaningful disbursements. Moreover, the end point of the IMF arrangement will determine the furthest possible end point for any related Paris Club rescheduling (barring a Jordan-style exit rescheduling—see below).

There are also precedents for bilateral debt relief outside the Paris Club but none of these appear to be relevant to Indonesia now. In almost all cases, very strong political motivations have been present. These include the cases of Egypt (in the early 1990s) and Jordan (in the mid-1990s). The UK has supplemented debt relief in the Paris Club with bilateral debt cancellation for a number of the HIPCs during the past 5-6 years.

Since debt owed to Japan accounts for one third of the Indonesian government's external debt to all creditors ($24.8 billion out of $73.8 billion) and more than half of its debt owed to bilateral official creditor agencies ($24.8 out of $30.4 billion), a small percentage of cancellation could yield a substantial benefit. However, there appear to be no precedents for bilateral cancellation by Japan. Furthermore, it would be contrary to current Japanese policy on debt relief and domestic considerations would argue against it (forgiving debt owed by Indonesia could stimulate demands for cancellation of debt owed by domestic borrowers at a time of severe fiscal strain in Japan).

B. Paris Club Debt Reduction

Can Indonesia receive debt reduction from the Paris Club? Almost certainly not in 2004, unless Indonesia' economic prospects take a sharp turn for the worse and a lengthy default appears imminent, or the political environment changes greatly.

The Paris Club has agreed to outright debt reduction in negotiations with 34 countries since 1995. These were nearly all low-income countries. Only five had per capita incomes in 2001 above Indonesia's $680: Bosnia-Herzegovina ($1240), Bolivia ($940), Yugoslavia ($940), Guyana ($840), and Republic of the Congo (Brazzaville, $700). The first five fall in the World Bank category of "lower middle income countries" while the Congo joins Indonesia in the category of "low-income countries" on the basis of having per capita income below $745 in 2001. (Since 1995, the Paris Club has concluded 93 agreements with 51 countries.)

Debt reduction for these 34 countries has been extended by applying "Naples terms" (50-67% reduction measured by Net Present Value), "Lyon terms" (80%), or "Cologne terms" (90%)—sometimes applied to the stock of outstanding pre-cutoff debt, and sometimes applied to the principal and interest payments falling due during the "consolidation period." These terms were adopted at successive G7 Economic Summits to address poverty in the world's poorest countries. Most of these countries are eligible for the HIPC Initiative being carried out to help poor countries that have unsustainable amounts of debt owed to multilateral agencies. However, Indonesia does not meet the HIPC criterion for being heavily indebted.

Yugoslavia was a special case. Its reduction (51% on non-ODA debt) was related to the breakup of the country and Yugoslavia's acceptance of obligations that did not directly benefit specific former constituent republics. Bosnia-Herzegovina received special treatment because of the conflict in the Balkans.

The Paris Club extended implicit debt reduction in two exceptional cases: Pakistan in 2001 and Jordan in 2002. Debt reduction was implicit in these cases because it was achieved through unusually long consolidation periods or repayment periods.

Significantly, there were very strong political motivations for the exceptional treatment of these two countries. (See Annex A.)

Five countries in addition to Indonesia obtained "Houston terms" since 1995: Ecuador, Jordan, Nigeria, Pakistan, and Peru. Three of these are "lower middle income" countries with per capita incomes above Indonesia (Peru-$2000, Jordan--$1750, Ecuador--$1240). Two have per capita incomes substantially below Indonesia (Pakistan--$420, Nigeria--$290).

Seven countries since 1995 received "ad hoc" treatment by the Paris Club: Albania, Georgia, Kenya, Macedonia, Pakistan, Russia, and Yugoslavia. Indonesia's 1998 rescheduling is considered "ad hoc" by the Paris Club. No precedents of interest to Indonesia were set in these cases.

Five countries since 1995 received "classic" treatment: Algeria, Croatia, Djibouti, Gabon, and Kyrgyz Republic. These cases involved minimal rescheduling.

To summarize, in theory Indonesia might be able to obtain "Naples terms" (50-67% debt reduction) for payments due on pre-cutoff non-ODA debt during its next "consolidation period" or on the outstanding stock of its pre-cutoff non-ODA debt. However, from the perspective of the rest of the world, Indonesia does not appear to be a heavily indebted country. The perception is that Indonesia's economy is performing substantially below its potential. With continued progress in maintaining macroeconomic stability and implementing structural reforms, its capacity to service debt is expected to grow more rapidly than its debt grows.

More to the point, seeking debt reduction would be seen as a step backward by the global investment community. As a result, the Indonesian government could lose the opportunity to borrow in international capital markets in the medium term and domestic companies could end up paying higher risk premiums for any external borrowing they undertake.

C. More Paris Club Debt Rescheduling

To avoid the economic impacts associated with an abrupt exit from exceptional financing in 2004, Indonesia could seek a phased exit from Paris Club debt rescheduling over the 2004-2006 period. Three distinct exit paths are examined to help clarify the advantages and disadvantages: maximum relief over the 2004-2006 period, a 30-month phaseout, and an 18-month phaseout. There are many possible variations on these three paths. The amount of pre-cutoff principal due in 2004 is $2.3B and the amount of interest due is $0.7B. The corresponding amounts of principal due in 2005 and 2006 are $2.1B and $1.9B. The amounts of interest due decline to $0.6B in 2005 and $0.5B in 2006. (See Table One)

Table 1: Indonesia's Debt to Paris Club Creditors
($ millions)

Stock (end 2001 or mid-2002)	Category	2004		2005		2006	
		P	I	P	I	P	I
27,075	**Pre cutoff**	**2269**	**690**	**2081**	**594**	**1938**	**519**
19,102	ODA	1169	455	1188	423	1205	392
7,973	Non ODA	1100	235	893	171	733	127
6,563	**Post cutoff**	**203**	**151**	**362**	**139**	**368**	**126**
3,744	ODA	9	66	11	65	31	67
2,819	Non ODA	194	85	352	74	337	59
2,278	**Paris Club I**	**215**	**110**	**242**	**95**	**255**	**80**
473	ODA	15	12	29	11	29	10
1,805	Non ODA	200	98	213	84	226	70
4,426	**Paris Club II**	**100**	**266**	**206**	**256**	**214**	**245**
1,866	ODA	0	55	0	54	0	54
3,560	Non ODA	100	211	206	202	214	191
5,408	**Paris Club III***	**0**	**254**	**0**	**254**	**0**	**254**
2,345	ODA	0	70	0	70	0	70
3,063	Non ODA	0	184	0	184	0	184
45,750	**TOTAL**	**2777**	**1217**	**2891**	**1084**	**2775**	**970**

* Estimate
Source: Bank Indonesia, faxes to Rieffel, 7 and 8 October 2002

Maximum relief. Indonesia could seek full rescheduling of Paris Club principal and interest in 2004 -2006 under a 3-year IMF arrangement starting at the beginning of 2004. This could be quite difficult. There were questions about the case for rescheduling interest payments in 2003 under Paris Club III. If Indonesia is successful in reducing the burden of its domestic debt over the next year, growth continues at the present rate or higher, and aid flows pick up, the Paris Club may refuse to continue rescheduling principal and interest. The Paris Club might agree, however, to reschedule principal only for another 3 years, partly on the grounds of supporting the political transition in 2004-2005 and giving the new government some "breathing room."[7]

[7] A lively debate is taking place at the G-7/IMF level about using excessively optimistic assumptions in the design of IMF-supported adjustment programs (for countries like Argentina as well as for HIPCs. This debate could be relevant to expectations for Indonesia's recovery and need for external support.

Phase out in 2006. Indonesia could phase out Paris Club rescheduling a bit faster by replacing the current IMF arrangement with a new 3-year one in mid-2003 and then seeking another 30 months of rescheduling from the Paris Club (through mid-2006). The Paris Club would presumably find this a more attractive option because it implies resuming full servicing of scheduled obligations in mid-2006. This could be reinforced by resuming interest payments to Paris Club creditors in 2004 or 2005 or at the beginning of 2006.

Phase out in 2005. Indonesia could pursue a more rapid phase out of Paris Club debt relief that would leave the new government with a "clean slate." For example, Indonesia could agree to pay all scheduled interest payments from the beginning of 2004 and to pay 50 percent of principal payments as well in 2005. As it did in Paris Club III, the creditors would probably make rescheduling in 2005 (whatever the level) contingent upon satisfactory performance under Indonesia's IMF arrangement. This could be a problem for the new government if performance criteria were missed for the third and fourth quarters of 2004.

D. Fallback Options

Indonesia may begin 2003 with a viable plan for phasing out exceptional financing after 2003, but internal or external developments could push the country off this path. For example, an industrial country recession could hit Indonesian exports, debt problems in other countries could inhibit access to borrowing from private sources, or developments in the Middle East could lead to a sharp drop in oil prices. Under these circumstances, proceeding through 2004 without an IMF arrangement or a Paris Club agreement, payment strains could develop before the end of the year and arrears to Paris Club creditors might begin to accumulate.

Resume serial debt rescheduling in 2005. One possible response by the new government to such circumstances would be to give a high priority to negotiating a new arrangement with the IMF and a fourth Paris Club agreement (for one or two or three years). This might be in place at the beginning of 2005.[8]

Long-term exit rescheduling in 2005. Taking advantage of a clear mandate from the voters, the government may be in a position to adopt a strong 3-year program of structural reforms supported by the IMF and on the basis of this program seek a Jordan-style exit rescheduling over the 2005-2010 period.

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[8] An extreme option would be to abandon the goal of resuming normal relations with creditors and to take steps to qualify for HIPC-style debt reduction from Paris Club and multilateral creditors, but this seems completely inconsistent with the goals of the current government and has no obvious economic advantages.

Table 2: Indonesia's Public Sector Debt and Debt Service, 2001-2004
(Rp trillions)

	2001	2002	2003	2004
Total interest payments	88.6	88.5	80.9	73.7
(Domestic debt)	(60.0)	(59.5)	(51.9)	(46.3)
(External debt)	(28.6)	(29.0)	(29.0)	(27.4)
Total budget receipts	273.5	301.9	327.8	367.5
Tot int pay/receipts	32.4%	29.3%	24.7%	20.0%
Domestic	21.9%	19.7%	15.8%	12.6%
External	10.5%	9.6%	8.9%	7.4%
GDP	1,491	1,705	1,939	2,178
Debt service/GDP	5.9%	5.2%	4.2%	3.4%
Internal debt stock	647	652	632	612
Int. Debt/GDP ratio	43.4%	38.2%	32.6%	28.1%
External debt stock	656	675	684	667
Ext. Debt/GDP ratio	44.0%	40.0%	35.3%	30.6%
Exports	604	487	507	532
External debt service	50.4	50.8	45.7	68.9
(Interest)	(28.6)	(29.0)	(29.0)	(27.4)
(Principal)	(21.8)	(21.8)	(16.7)	(41.5)
Ext. debt svc/Exports	8.3%	10.4%	9.0%	13.0%

Source: Wallace (Back of the envelop) budget worksheet, 30 September 2002 for budget and debt service numbers also for data base for GDP and exports. Internal and external debt from World Bank/Indonesia web site.

Annex

Jordan's Exit Rescheduling

In July 2002, Jordan obtained an "exit rescheduling" from the Paris Club that has possible relevance to Indonesia's case.

Jordan began obtaining debt relief from the Paris Club in 1989 and went back to the Paris Club for follow-on rescheduling on five subsequent occasions including the most recent one. Jordan got standard medium-term rescheduling terms in the first two operations. In the rest, like Indonesia, Jordan obtained "Houston terms," in the form of long-term rescheduling (no principal reduction) available for "highly indebted lower middle-income countries."

The July 2002 agreement rescheduled pre-cutoff (Jan 1989) debt only, but it consolidated all payments falling due in the 2002-2007 period on a phased basis: 100 percent reduction from Jan 2002 to June 2004, 90 percent from July 2004 to Dec 2005, 80 percent in 2006, and 70 percent in 2007. After 2007, it is assumed that Jordan will not require any further rescheduling.

The amounts rescheduled are to be repaid over 20 years (including a 10-year grace period) for ODA debt and 17 years (including a 3-year grace period) for non-ODA debt.

The total payments originally due on pre-cutoff date debt in the 2002-2007 period were $2 billion and this operation will reschedule $1.2 billion of these payments.

Jordan's public sector external debt at the end of 2002 was around $7.3 billion. Debt owed to Paris Club creditors represented $4.1 billion ($2.3 billion pre-cutoff and $1.8 post-cutoff). Only $500 million (23 percent) of the pre-cutoff debt is ODA, but $1.5 billion of the post-cutoff debt is ODA. As usual, interest charged on rescheduled ODA debt is "at least as concessional as the original loans," while interest charged on rescheduled non-ODA debt is at "the appropriate market rate."

Two other interesting features of the Jordan case:

- The Paris Club agreed to exempt Jordan's outstanding bond debt (similar in magnitude to Indonesia's) from "comparable treatment."

- In the mid-1990s, the US unilaterally forgave $700 million of debt for political reasons. (This was done selectively, with most of the debt cancelled being direct military loans and concessional PL480 loans.)

N.B. Jordan's per capita annual income in 2001 ($1,750) was more than twice as high as Indonesia's ($680).

Pakistan's Stock Rescheduling

In December 2001, Pakistan received exceptionally generous rescheduling terms from the Paris Club.

Pakistan's recent debt difficulties resulted from nuclear weapons tests carried out in 1998 that led to a suspension of aid from Pakistan's major donor countries. A conventional (Houston terms, like Indonesia's) rescheduling was carried out in January 1999. Following the terrorist attacks on the US in September 2001 and the campaign to replace the government in Afghanistan, Pakistan played a key role as a "front line" state, providing considerable support to this campaign.

The Pakistan rescheduling was exceptional because it: (a) rescheduled the entire stock of pre-cutoff debt, not just the payments falling due during a limited "consolidation period;" (b) deferred for an unusually long period of time the repayment of this debt; and (c) provided relief on some post-cutoff principal and some interest on rescheduled debt. More precisely:

	Pakistan	Indonesia
--Relative stocks of debt:		
Cutoff date:	30 Sept 1997	1 July 1997
Pre-cutoff ODA stock:	$8.8B	} $35.0B
Pre-cutoff non-ODA stock:	$3.7B	}
Post-cutoff stock:	$0.9B	$6.4B
Total:	$13.4B	$41.4B
--Treatment:	Pre-cutoff stock ($13.4B)	Pre-cut-off flow (1 April 2002-31 Dec 2003) ($5.4B)
--Repayment:		
Pre-cutoff ODA debt:	38 years, incl. 15 years of grace	20 years, incl. 10 years of grace
Pre-cutoff non-ODA debt:	23 years, incl. 5 years of grace	18 years, incl. 5 years of grace
--Additional cash flow relief:		
Post-cutoff principal:	30 Nov 2001-30 June 2002 rescheduled	None
Pre-cutoff interest:	1 Dec 2001-30 June 2002 rescheduled	None
	1 July 2002-30 June 2004 20% rescheduled	None

Significantly, the Paris Club's relief was granted in the context of a 3-year arrangement under the IMF's concessional Poverty Reduction and Growth Facility. Normally, the negotiation of a program supported by a PRGF arrangement is quite time-consuming and involves elaborate and comprehensive structural reforms as well as tough macroeconomic objectives. (The process is designed primarily for HIPCs.) Pakistan's per capita annual income in 2001 was $420 compared with $680 for Indonesia.)

Other Relevant Cases

A. Cote d'Ivoire

Cote d'Ivoire's annual per capita income in 2001 was slightly below Indonesia's ($630 vs. $680). Cote d'Ivoire is an oil producer, like Indonesia. Unlike Indonesia, its government borrowed heavily from private sources in the 1980s and had to seek debt reduction from its commercial bank creditors. In [1996], Cote d'Ivoire completed a Brady Plan exchange of commercial bank debt for bonds.

Cote d'Ivoire went back to the Paris Club in April 2002 after a period of severe political instability. The Paris Club granted Cote d'Ivoire "Lyon terms", which involves a degree of debt reduction (80%) between Naples terms (67%) and Cologne terms (90%).

Significantly, the Paris Club's relief was granted in the context of a 3-year arrangement under the IMF's concessional Poverty Reduction and Growth Facility. Cote d'Ivoire's per capita annual income in 2001 was $630 compared with $680 for Indonesia. Unlike Indonesia, it is eligible for the HIPC initiative to reduce multilateral debt, not by virtue of the size of its external debt relative to GDP but by virtue of the size of its payments on external debt as a share of its total budget [revenues/expenditures]. (The Paris Club also agreed to top up the reduction to 90% as soon as Cote d'Ivoire reached its "decision point" under the HIPC Initiative.) With the recent rebellion in Cote d'Ivoire, its economic recovery program has presumably been disrupted

	Cote d'Ivoire	Indonesia
--Relative stocks of debt:		
Cutoff date:	1 July 1983	1 July 1997
Pre-cutoff stock:	$2.7B	$35.0B
Post-cutoff stock:	$1.5B	$6.4B
Total:	$4.2B	$41.4B
--Treatment:	Pre-cutoff flow (1 April 2002- 31 Dec 2004) $1.8 billion of which $1.1 in arrears	Pre-cut-off flow (1 April 2002-31 Dec 2003)
--Cancellation/Repayment:		
Pre-cutoff ODA payments:	40 years, incl. 16 years of grace	20 years, incl. 10 years of grace
Pre-cutoff non-ODA cancellation:	80% of amounts due	None
Pre-cutoff non-ODA debt:	23 years, incl. 6 years of grace uncancelled amounts	18 years, incl. 5 years of grace

B. Nigeria

Nigeria's annual per capita income in 2001 was less than half of Indonesia's ($290 vs. $680). Nigeria is an oil producer, like Indonesia. Unlike Indonesia, its government borrowed heavily from private sources in the 1980s and had to seek debt reduction from suppliers and the London Club. In [1994], Nigeria completed a Brady Plan exchange of commercial bank debt for bonds. Despite its low per capita income, Nigeria is not eligible for the HIPC Initiative because its stock of external debt is not high relative to its GDP.

The Paris Club rescheduling with Nigeria in 2000 followed earlier ones in 1986, 1989, and 1991. The Nigerian case is exceptional for several reasons.

First, following the imposition of military rule in [1994] donor countries suspended aid and Nigeria reacted by suspending payments to donor countries. Nevertheless, it continued to service its restructured debt to commercial creditors (Brady bonds). As a result of the aid cutoff and payment suspension, arrears to Paris Club creditors accumulated very rapidly due to interest charged on arrears and penalty interest. After a new government was elected democratically in [2000], donor aid resumed, Nigeria reached agreement with the IMF on a stand-by arrangement, and the Paris Club rescheduled outstanding arrears along with principal and interest payments falling due from mid-2000 to mid-2001.

Second, for political reasons, Nigeria's stand-by with the IMF was "precautionary," which means that Nigeria did not plan to make any drawings.

Third, this rescheduling was viewed by the creditors as a transitional arrangement. They expressed a positive attitude toward reducing Nigeria's debt in a subsequent negotiation as long as Nigeria was meeting the objectives of its IMF-supported program.

The results were discouraging from the creditor point of view. Nigeria's performance was poor and its program quickly went off track. Without a new program, Nigeria was unable to obtain Paris Club rescheduling of payments falling due after mid-2001 and arrears began to accumulate again. It is remarkable that following the recent IMF/World Bank annual meetings in Washington, there were press reports that the IMF hopes to conclude a new arrangement with Nigeria at the beginning of 2003. This appears to reflect more domestic pressure on donor countries to reduce Nigeria's debt than progress by Nigeria in adopting policies consistent with sustainable growth.

	Nigeria	Indonesia
--Relative stocks of debt:		
Cutoff date:	1 Oct 1985	1 July 1997
Pre-cutoff stock:	$23.1B	$35.0B
(of which arrears)	($21.0B)	(0)
Post-cutoff stock:	$1.4B	$6.4B
Total:	$24.5 B	$41.4B
--Treatment:	Pre-cutoff flow (1 Aug 2000- 31 July 2001)	Pre-cut-off flow (1 April 2002- 31 Dec 2003)
--Repayment:		
Pre-cutoff ODA payments:	20 years, incl. 10 years of grace	20 years, incl. 10 years of grace
Pre-cutoff non-ODA debt:	18 years, incl. 3 years of grace	18 years, incl. 5 years of grace
Post-cutoff payments:	5 years (a portion of arrears and due in 2000 only)	None
--Capitalization of interest:	100% of interest on pre-cutoff debt due Aug 2000-July 2001	None